



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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John G. Morgan
Comptroller

May 8, 2001

Memorandum

TO: The Honorable Don Sundquist
Governor

The Honorable Douglas Henry, Jr., Chairman
Senate Finance, Ways, & Means Committee

The Honorable Matt Kisber, Chairman
House Finance, Ways, & Means Committee

FROM: Steve Adams, State Treasurer

Riley Darnell, Secretary of State

John Morgan, Comptroller of the Treasury

Warren Neel, Ph.D., Commissioner
Department of Finance & Administration

SUBJECT: Revision to Revenue Estimates for FY 2000-01 and FY 2001-02

The State Funding Board met at 1:00 p.m. on May 7, 2001 in Room 16 of the Legislative Plaza for the purpose of considering whether the consensus ranges of revenue estimates previously recommended by the Board should be modified. During this meeting, the Board heard testimony from Dr. Albert DePrince of Middle Tennessee State University, Mr. James Davenport of the Fiscal Review Committee, and Dr. William Fox of the University of Tennessee, Knoxville. Dr. John Gnuschke of the University of Memphis was invited to present but was unable to attend. The revenue estimates provided by each of the presenters are summarized in the attachments to this memorandum. The consensus revenue ranges contained in this memorandum update and replace those transmitted to you on December 11, 2000.

At the time of the meeting, complete information for April, 2001 collections was unavailable. However, testimony to the Board indicated that, with the exception of the franchise, excise, and income taxes, collections for all other tax types continued to be

sluggish. In particular, sales tax collections for April, 2001 appear to be negative when compared to the same month last year. In contrast, franchise and excise tax collections appear to be robust, permitting these tax types to meet current year to date budgetary estimates.

Each of the presenters reduced their revenue estimates from forecasts made in December, 2000. During this meeting, several factors were identified that have led to this change, including an economy that, while not in recession, is growing at a much slower rate than seen in recent years. Among factors impacting sales tax growth are weakness in automobile sales and a fall off in home starts from levels seen in the past few years. Presenters were asked to identify the risks to their current estimates of revenue. In summary these risks included:

- General Economic Conditions: all presenters based their current forecasts on the assumption that economic activity will increase moving into the last half of fiscal year 2001-02. Failure of the economy to do so will place all estimates of revenue growth in jeopardy.
- Gasoline Price Increases: Dr. Fox noted that recent increases in the price of gasoline has had a dampening effect on sales tax growth. In essence, a dollar that a consumer must spend on gasoline is a dollar that cannot be spent on sales taxable purchases. Dr. Fox estimates that each \$0.01 rise in gasoline prices decreases sales tax revenues by approximately \$1.7 million.
- LLC's / LLP's : It was noted that approximately \$135 million of franchise and excise receipts for FY 2000-01 arose from LLC's / LLP's that were brought into the state tax system through legislation enacted in 1999. Two issues were discussed in this context. First, absent the impact of these entities, growth in franchise and excise taxes was flat meaning there has been no improvement in the underlying tax base for these major taxes. This raises questions about the wisdom of assuming significant growth in these tax types going forward. Second, there is a concern that a significant number of LLC's & LLP's will surrender their status as limited liability entities since they are now in a position to evaluate the cost of liability protection through the state as limited liability entities (for which they pay state corporate taxes) versus the cost of obtaining liability protection through the purchase of insurance (and thereby avoiding state corporate taxes). Should a significant number of limited liability entities elect to do so, the state could experience negative growth in corporate taxes during FY 2001-02.

As a final note, each presenter believed their estimate of revenue growth to be reasonable, however, there was general agreement that use of more conservative estimates are appropriate for purposes of state budgeting, especially given the risks identified to achieving these estimates.

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Based on the testimony received, the Board concludes that it is appropriate to modify the consensus revenue ranges which were transmitted on December 11, 2000 as follows:

	FY 2000-01		FY 2001-02	
	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>
Total State Taxes	1.00%	1.50%	2.50%	3.00%
General Fund Only	1.20%	1.70%	2.60%	3.10%

The FY 2000-01 revenue estimate contained in the budget as introduced anticipated a reduction of \$175.8 million for total taxes and \$153.8 million for the general fund. These budget document estimates fall within the above revenue ranges for FY 2000-01. A precise estimate of the impact of these ranges for FY 2001-02 is dependent upon where the estimate for FY 2000-01 is set; however, a downward adjustment in FY 2001-02 revenue estimates would likely fall in the neighborhood of \$77 million for total taxes and \$50 million for the general fund. A more precise range can be determined once an estimate for FY 2000-01 is established.

The Board believes these consensus revenue growth ranges to be reasonable and appropriate for use in state budgeting. However, these estimates do anticipate that the current over-collection of franchise and excise tax is maintained for the remainder of FY 2000-01.

Please do not hesitate to contact us if you wish to discuss this further.

Attachment

cc. The Honorable John S. Wilder
The Honorable Jimmy Naifeh